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RECEIVED

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: *Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45 et al.;
Access Charge Reform, CC Docket Nos. 96-262 et al.

Dear Ms. Salas:

This letter responds to the recent United States Telephone Association ("USTA") proposal for universal service support for non-rural carriers. See September 18, 1998 Letter of John W. Hunter to Magalie Roman Salas, attaching "Preserving Universal Service In Competitive Markets For Non-Rural Carriers, A Plan Proposed By USTA (September 14, 1998) ("*USTA Prop.*"). Although USTA's proposal is remarkable in its lack of clarity, those few elements that are clearly expressed starkly reveal that it is wholly at odds with the requirements of the 1996 Act and the Commission's policies. In the guise of a "consensus" plan that represents large incumbents' "united position" on universal service support, *id.* at 1, USTA urges the Commission to inflate the federal high cost fund by the full amount of the more than \$3.5 billion that incumbents currently receive in the form of CCL and PICC access revenues. See *USTA Prop.* at 6. No effort would be made to determine whether funding at that extravagant level -- more than *ten* times the current level of federal high cost support -- is remotely necessary to foster universal service. See *USTA Prop.* at 6. This new "support" would not be allocated on the basis of relative cost or need; rather, each dollar collected would automatically be funneled back to the same incumbent LEC study area from which it came. See *id.* To close the circle, the resulting windfalls available in each study area would then be concentrated in those areas where the incumbent USTA member is most likely to retain customers and the associated "support." See *id.* at 7. Thus, the very Commission-approved cost model that USTA would have the Commission ignore for cost estimation purposes would be used for the quite improper purpose of channeling the bulk of the windfalls to the remotest, most sparsely populated rural areas in each study area that are least likely to be subject to significant competition in the near term. See *id.* at 6. This "universal service" proposal has nothing to do with universal service and everything to do with the protection of incumbents' monopoly revenue streams. It cannot be taken seriously and should be rejected out of hand.

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The USTA proposal has obvious appeal when viewed through an incumbent monopolist lens – by transforming bloated and indefensible access charge elements into protected “universal service” subsidies, the proposal would allow these incumbents: (i) to sidestep pro-competition efforts to drive access charges toward cost, and (ii) to postpone the inevitable cost analyses that will demonstrate once and for all that the multiple above-cost revenue streams that incumbents have for decades touted as “implicit” universal service support are, in fact, wholly unnecessary for that purpose. But when measured against the requirements and goals of the Telecommunications Act of 1996 (“Act”), the Commission’s established policies, and the interests of consumers and competition, the USTA proposal is clearly bankrupt. It is flatly inconsistent with Congress’ central command that the new explicit universal service mechanisms be sized to provide a level of support “sufficient” to foster universal service. It would sweep aside years of effort and progress towards meeting that goal, culminating most recently in the Commission’s selection of a competitively neutral cost model platform for estimating the efficient forward-looking costs of providing universal service. It would bring to a screeching halt pro-competition efforts to remove the fat from access charges. It would undermine the Commission’s local competition policies by encouraging inefficient entry in pursuit of “portable” windfalls. And, when considered against the backdrop of state universal service reform, it would guarantee the very confusion, inconsistency and double counting that the specific, predictable and explicit mechanisms mandated by the Act were designed to prevent. Any one of these concerns would be a sufficient ground for rejecting the USTA proposal; together, they constitute an overwhelming case against that proposal.

Inconsistency With The Act. The Act, 47 U.S.C. § 254, mandates an end to the current “patchwork quilt of implicit and explicit subsidies.” *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order at ¶ 5, 11 FCC Rcd 13042 (1996) (“*Local Competition Order*”). In its place, Congress directed regulators to establish explicit support mechanisms “sufficient” to foster universal service. See 47 U.S.C. § 254(b)(5). As the Commission has repeatedly recognized, the “sufficiency” of a support subsidy necessarily is a function of the cost of providing service. See, e.g., *Federal-State Joint Board on Universal Service*, First Report and Order at ¶ 225, 12 FCC Rcd 8776 (1997) (1997) (“*Universal Service Order*”). Indeed, in a rare instance of candor, USTA itself concedes that a “necessary step (which has been avoided up to now) is for regulators to ‘size’ the implicit support embodied in current rates.” *USTA Prop.* at 3. Three pages later, however, USTA makes clear that its proposal would forego that “necessary” step. See *id.* at 6.

Specifically, USTA’s plan would shift the entirety of CCLC and PICC revenues¹ to the explicit high cost fund. But in designing these access rate elements years ago, the Commission never set out to size them to be cost-based universal service subsidies – it certainly did not, in that embedded cost environment, purport to establish charges that reflect *forward-looking* costs. Thus, there is no conceivable basis for simply assuming, as USTA does, that the CCLC and PICC represent only legitimate universal service costs and *no* access windfall. Indeed, the

¹ USTA makes clear that its proposal covers not only current PICC revenues but also revenues from other rate elements currently targeted for transfer to the PICC. See *USTA Prop.* at 6.

Commission has adopted mechanisms designed to subject those access rate elements to competition precisely *because* they exceed the legitimate costs of access and universal service. See *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982 (1997) ("*Access Charge Reform Order*"), *aff'd sub nom.*, *Southwestern Bell Tel. Co. v. FCC*, ___ F.3d ___ (8th Cir., Aug. 19, 1998). In short, whatever its policy basis, the USTA proposal cannot be squared with the plain terms of the Act. See *USTA Prop.* at 4 ("the goals of the new universal service policy should be to . . . [i]dentify and establish universal service support mechanisms consistent with the terms of the 1996 Act").

Inconsistency With The Commission's Established Policies. The USTA plan is also flatly inconsistent with policies established over the past three years in each of the "trilogy" of actions through which the Commission has sought to implement the central goals of the Act: universal service, access reform, and local competition. In this regard, the USTA proposal would signal an enormous step backward for both the Commission and the industry.

This irreconcilable conflict is most obvious with respect to the Commission's established universal service policies. The Commission, state regulators, and the industry have been toiling for nearly three years to replace the anticompetitive patchwork of existing subsidies to incumbent local exchange carriers with explicit, competitively neutral universal service mechanisms. From the outset, both the Commission and the Joint Board have recognized that only principled way to *size* the federal fund consistent with the requirements of the Act is by reference to the forward-looking economic costs that drive carriers' entry and investment decisions. See *Universal Service Order* at ¶ 224 ("We agree with the Joint Board's recommendation that the proper measure of cost for determining the level of universal service support is the forward-looking economic cost of constructing and operating the network facilities and functions used to provide the supported services").

Over the past eighteen months the Commission and the industry have invested literally millions of hours developing a cost estimation tool consistent with this forward-looking approach. USTA members played an extremely active role in that process, which culminated last week when the Commission released its order adopting a model platform that, in the Commission's words, combines "the best elements" of cost models sponsored by the Commission's staff, entrants and USTA members. *Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45 *et al.*, Fifth Report and Order at ¶ 4 (October 28, 1998) ("*Cost Model Platform Order*"). The upshot of all of this hard work is that once the necessary input values have been selected the Commission will be in a position to determine -- on a principled basis -- the amount of support that is "sufficient" in each area to foster universal service.

Now that this arduous process is nearly complete, USTA urges the Commission to abandon both its cost model and the economic principles it implements for determining the level of universal service support. USTA offers no justification for doing that, and there is none. USTA's complaint cannot be with universal service cost modeling *per se*, because, as noted, USTA members *supported* the cost model approach. Further, as discussed below, USTA itself proposes using cost models both to disaggregate support within study areas and, apparently, even to determine the absolute amounts of "additional" and *intrastate* support. In these circumstances, it is clear that USTA's proposal is motivated solely by incumbents' desire to

insulate monopoly revenues from competition, a fact that is confirmed by USTA's failure to propose any alternative principle for sizing the federal fund beyond the empty admonition that "the fund should be sized based on the need to support universal service and on the need to replace other sources of support." *USTA Prop.* at 6.

Indeed, USTA's proposal fails to meet even USTA's own stated universal service criteria. Thus, for example, USTA opines that "states with a large number of high cost areas (rural) and relatively few low cost areas (urban) should receive proportionately more support." *USTA Prop.* at 5. The Commission's cost model approach will clearly meet that criterion – basing support on the costs of providing service as determined by cost model estimation will, by definition, ensure that states with relatively more high cost areas receive proportionately more support. And USTA's proposal to re-label access charges as universal service support just as clearly will *not* meet that criterion. As USTA makes clear, its plan would allocate this "support" not on the basis of relative proportion of high cost areas, but instead solely on the basis of which study areas happen to have higher access charge collections today. This arbitrary approach plainly could not help but favor certain incumbents over others, and one does not have to read too far between the lines to see that this apparently caused a rift in the USTA "consensus." The "fix" is a vague reference to "[a]n equitable mechanism based on a cost benchmark" that would be used "to identify those states which will need *additional* support due to significant numbers of high cost customers." *USTA Prop.* at 5 (emphasis added).² No further explanation is provided, and with good reason – any focus on the need to employ a "cost benchmark" to measure sufficient support would expose the "consensus" access charge protection proposal, which has no cost basis, for the ruse that it is.

USTA's plan is also in direct conflict with the Commission's ongoing access reform efforts. One of the primary reasons the Commission adopted its market-based approach to access charge reform was its belief that market forces would eliminate the access windfall and drive access charges to cost. *See USTA Prop.* at 2 ("a number of services are priced substantially above cost (*e.g.*, access)"). By permanently embedding the access windfall reflected in CCL and PICC revenues in the universal service fund, USTA's proposal would, for the foreseeable future, destroy any chance that these access charges would be subjected to the competitive forces envisioned by the Commission.³ USTA would ensure that result by using the Commission's cost estimation tool not to estimate costs but to shuffle the re-labeled access charges in each study area to remote, sparsely populated areas served only by the incumbents. That would be wholly improper. The selected cost model estimates the cost of providing universal service and

² As outlined by USTA, even this resort to cost model estimation would be unabashedly result-oriented, as USTA proposes to link the level of the revenue benchmark to the level of the cost estimate, thereby reaching the same funding result regardless of the size of the cost estimate. *See USTA Prop.* at 5-6

³ As AT&T and others have demonstrated the Commission's market-based approach is not alone sufficient to reduce access charges to competitive levels in a reasonable time frame. Rather, the Commission should also immediately grant the Consumer Federation of America's petition for a rulemaking and implement further access charge reforms.

therefore can properly serve as the means of allocating *legitimate* support both among and within study areas.⁴ But cost estimation tools can provide no useful guide how to allocate pure windfalls. That is solely a matter of policy, and, given the undeniable competition-distorting effects of favoring particular competitors over others, it is clear that USTA's proposal has it exactly backwards. If such windfalls are to be tolerated at all – and both the Act and the Commission's established policies make clear that they should not – those windfalls should be allocated to areas where competition is fiercest. In that way, there would at least be the hope that the windfalls would be competed away relatively quickly.

Nor would the Commission's established local competition policies to promote efficient entry and investment escape the destructive path of the USTA proposal. As the Commission recently reiterated, a forward-looking cost-based support mechanism “will send the correct signals for entry, investment and innovation” “eliminates incentives to invest inefficiently,” and “is competitively and technologically neutral.” *Cost Model Platform Order* at ¶¶ 9-10. In contrast, the USTA proposal, which would create greatly inflated subsidy “prizes,” would send all the wrong entry signals and encourage inefficient entry and investment in pursuit of the re-labeled access windfall.

Interplay with State Universal Service Reform. In a final nod to chaos, USTA hints at an additional maneuver to exploit the interrelationship between federal and state support for the same services. All increases in federal high cost funding beyond the mere transfer of CCL and PICC revenues to the high cost fund should, USTA suggests, be offset not by further reductions to interstate access charges, but by “*intrastate rate reductions.*” *USTA Prop.* at 5. Although USTA offers no explanation for this odd approach, its aim is obvious – if the Commission were to sanction USTA's backdoor attempt to increase the federal universal service burden, USTA's members could then lobby state regulators to seize the bonanza and refuse to make the offsetting reductions to the intrastate rates over which the Commission has no control. And this is but one of the many ways in which the USTA proposal would perpetuate the information vacuum, uncertainty and confusion that have for so long allowed incumbents to exploit the subsidy game. For example, absent a cost-based federal fund, there would be no way to determine the extent of double-counting engendered by the interplay of that fund with a cost-based state fund (or worse yet, a state fund that, like USTA's federal fund proposal, is wholly arbitrary).

In sum, the appropriate course is clear. The Commission should reject USTA's proposed eleventh-hour wholesale abandonment of the Act's standards and the core principles of the Commission's universal service, access reform and local competition initiatives.

Sincerely,



⁴ This does not, of course, mean that any additional federal high cost support will, in fact, be required for non-rural companies.